

1983

Report of the Special Committee on Accounting Standards Overload

American Institute of Certified Public Accountants. Special Committee on Accounting Standards Overload

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Report of the Special Committee on Accounting Standards Overload

FEBRUARY 1983

Report of the Special Committee on Accounting Standards Overload

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American Institute of Certified Public Accountants

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Preface

This booklet contains the final report of the AICPA Special Committee on Accounting Standards Overload, a letter prepared by the Accounting Standards Executive Committee commenting on the report, and a letter from the chairman of the AICPA Board of Directors transmitting those documents to the Financial Accounting Standards Board.

The problem of accounting standards overload and the implications of proposed solutions are of vital concern to all those interested in the financial reporting process. Accordingly, this booklet is being widely distributed to those who received the special committee's December 23, 1981, discussion paper, including—

- Practice offices of CPA firms.
- Members of AICPA Council and chairpersons of AICPA technical committees.
- State society presidents, executive directors, and selected committee chairpersons.
- Organizations concerned with regulatory, supervisory, or public disclosure of financial activities.
- Persons who request copies.

Special Committee on Accounting Standards Overload

STANLEY J. SCOTT, *Chairman*

GERALD W. HEPP

ROBERT L. ISRAELOFF

JAMES P. LUTON, JR.

DAVID A. NELSON

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THOMAS P. KELLEY

Vice President—Technical

THOMAS W. MCRAE

*Assistant to the President—
Technical*

James J. Leisenring served on the Committee from its inception to October 1, 1982, and did not vote on the issuance of this report.



American Institute of Certified Public Accountants
1211 Avenue of the Americas, New York, New York 10036 (212) 575-6200

March 18, 1983

Mr. Donald J. Kirk
Chairman
Financial Accounting Standards Board
High Ridge Park
Stamford, Connecticut 06905

Dear Mr. Kirk:

We are submitting for the consideration of the Financial Accounting Standards Board the final report of the Special Committee on Accounting Standards Overload. We are also submitting a letter prepared by the Accounting Standards Executive Committee at the request of the Board of Directors commenting on the report.

The Board of Directors believes that accounting standards overload is a problem that must be addressed vigorously and expeditiously and that the final report and related letter of comment warrant the FASB's careful study. We believe the solution to the issues requires the mutual cooperation of both the FASB and the AICPA and we will continue to work towards a constructive solution.

Recognizing the interplay between standards overload and the FASB's current project on timely guidance, the FASB should be given a reasonable period within which to respond. Nevertheless, those who are concerned about these issues deserve a clear statement of the FASB's intentions and proposed course of action at the earliest possible date.

Sincerely yours,

A handwritten signature in cursive script that reads "Rholan E. Larson".

Rholan E. Larson
Chairman of the Board

REL:jd
Enclosure



American Institute of Certified Public Accountants

1211 Avenue of the Americas, New York, New York 10036 (212) 575-6200

February 14, 1983

To the AICPA Board of Directors:

Enclosed for consideration by the Board of Directors is the final report of the Special Committee on Accounting Standards Overload. The report has been approved by six members of the committee, of whom two, Robert Israeloff and Richard Nest assent with qualifications. One member, James Luton, dissents to the report. James J. Leisenring resigned from the committee on taking a position with the FASB and did not participate in the approval of the report. The statements of minority views are included in the report.

The charge to the committee asked that its report "be in detail sufficient to enable the Board of Directors to implement the recommendations without further work." The committee believes that its report is responsive to that request. The committee also believes that with the submission of this report to the Board it has completed its work and should be discharged.

The issues considered are complex, controversial, and significant. We recognize that achieving a broad consensus on a comprehensive program to provide meaningful relief from accounting standards overload will be difficult. However, we believe that the recommendations in our report provide the basis of a realistic program for providing such relief and urge the Board to give the highest priority to their implementation.

Sincerely,

A handwritten signature in cursive script, reading "Stanley J. Scott".

Stanley J. Scott
Chairman
Special Committee on Accounting
Standards Overload

SJS:rj
Enclosures

cc: Special Committee on Accounting
Standards Overload

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Report of the Special Committee on Accounting Standards Overload

FEBRUARY 1983

The AICPA Board of Directors established the Special Committee on Accounting Standards Overload (the Committee) in 1981 to-

study accounting standards overload and to consider alternative means of providing relief from accounting standards which are found not to be cost effective, particularly for small, closely held businesses, and to report thereon to the board of directors.¹

This report to the AICPA Board of Directors completes the Committee's work.

Conclusions and Recommendations

After considering the comments on our discussion paper and other available evidence,² we find that accounting standards overload is a real and pressing problem that must be addressed vigorously and expeditiously. The increasing specificity and complexity of mandated accounting standards have led to growing concern and mounting frustration, especially among small and closely held businesses and the CPAs who serve them. We find that the following factors have contributed to accounting standards overload:

- Too many standards
- Standards that are too detailed
- An inability to be selective in the application of standards
- Failure to provide sufficiently for differences between public and non-public entities, annual and interim financial statements, and large and small enterprises
- Requirements for excessive disclosures and complex measurements

1. Appendix A to this report presents the complete text of the Committee's charge.

2. AICPA, *Tentative Conclusions and Recommendations of the Special Committee on Accounting Standards Overload* (New York: AICPA, 1981). Appendix B presents a description of the Committee's proceedings, a summary and an analysis of the letters of comment on the discussion paper, and a description of other evidence considered.

Although all of these factors apply to all enterprises in varying degrees, we focused on the problem from the perspective of small nonpublic entities and the CPAs who serve them. Nonpublic entities span a wide spectrum from very small owner-managed enterprises to some very large enterprises. We have not defined the terms large and small, but it is important to note that they are relative terms whose meanings can and should vary depending upon the circumstances. For example, in terms of industry averages, a bank with \$50 million in assets or a supermarket chain with sales of \$50 million may be considered small, whereas manufacturing enterprises in the same size categories may be considered large. We believe that such differences should be considered in the standard-setting process. Also, we believe that in the process of establishing accounting standards and measuring their cost-benefit relationships, the special needs of the very large number of small nonpublic entities at the lower end of the size spectrum (for example, financial institutions with \$5 million in assets or grocery stores with sales in the range of \$200,000 to \$500,000) are, unfortunately, almost always overlooked.

We are convinced by all the evidence considered that accounting standards overload is a major problem and that its burden falls disproportionately on small nonpublic businesses and the CPAs who serve them. We are encouraged by the attention the problem is receiving from the Financial Accounting Standards Board and others. However, we believe a concerted and concentrated effort to relieve the burden of accounting standards overload must now be given the highest priority. The FASB has the structure and resources to provide the necessary relief on a timely and priority basis. The problem is of critical concern to a significant segment of practicing CPAs, and it has the potential of dividing the profession and eroding support for the FASB as the designated body to set accounting standards. Therefore, while the AICPA, as the national membership body of a unified profession, should cooperate fully with the FASB, it must at the same time act forcefully and give clear and consistent signals as to the direction it believes a solution should take. The AICPA must also take appropriate actions on its own. For example, it should undertake an effort to provide information that will help the profession resolve practice problems without seeking mandatory standards to deal with such problems.

Recommended FASB Action

The FASB is leading a major research effort that spans the range of private and small public companies. This effort includes obtaining responses from users, preparers, and accountants on two major issues:

1. Whether and to what extent the information needs of users of financial statements of small or closely held businesses differ from those of users of financial statements of large publicly owned businesses
2. The factors that influence the benefits and costs of providing financial information for small or closely held businesses

The initial phase of this research is nearing completion. We urge that the FASB carefully evaluate users' views of their needs against the often conflicting views of preparers and accountants who must satisfy those needs. Financial statement information is cost-free to third-party users, and most third-party users tend to want more rather than less.³ We believe that the critical evaluation of users' needs must be based on a delicate cost-benefit trade-off that distinguishes between users' wants and their basic needs.

We recognize the role of research in the FASB's effort to alleviate the accounting standards overload problem. But, as in the development of the FASB's conceptual framework project, the need for research in this area is likely to continue for a long time, and the results of present research are unlikely to provide timely, definitive answers to the accounting standards overload problem. We believe that just as accounting standards are being issued without the benefit of a completed conceptual framework, the FASB should now provide some relief from accounting standards overload based on an evaluation of current research results without waiting for definitive answers from more research.

We conclude that the FASB is the appropriate body to take effective action, both in the short term and the long term, to provide relief from accounting standards overload and recommend that—

- The FASB promptly reconsider and act on certain accounting standards that are widely perceived to be unnecessarily burdensome and costly, particularly for small nonpublic entities.
- In reconsidering existing standards and in developing new standards, the FASB's objective should be to simplify standards by avoiding complex and detailed rules for all entities to the extent feasible.
- To the extent that simplicity and flexibility are not feasible, the FASB should explicitly and specifically consider the information needs of the users of the financial statements of small nonpublic entities and the costs and benefits of developing the information with the objective of providing, within the framework of a unified set of generally accepted accounting principles, differential disclosure alternatives (based on

3. The available empirical research indicates that users' wants diverge widely from what they now accept and from the views of businessmen and accountants on what users *should* expect from financial statements.

the criteria in the Werner Committee Report) as well as differential measurement alternatives for such entities.⁴

Several existing standards that have been frequently criticized as unnecessarily burdensome and costly, particularly for small nonpublic entities, merit reconsideration by the FASB. We believe that definitive answers from research on users' needs are not required to justify reexamination of four of the most frequently criticized standards and urge immediate FASB reconsideration of—

1. The principles in FASB Statement no. 13 on accounting for leases and its amendments and interpretations.
2. The principles in Accounting Principles Board Opinion 11 on accounting for income taxes and related APB opinions, amendments, and interpretations.
3. The pro forma disclosures required by APB Opinion 16 on business combinations.
4. The principles in FASB Statement no. 34 on interest capitalization.

We recognize that the FASB now has reconsideration of the principles in APB Opinion 11 and related pronouncements on its active agenda and are encouraged by that recent action. We urge the FASB to give that project a high priority and to apply the approach recommended in this report.

Recommended AICPA Action

Based on our evaluation of the comments on the discussion paper and other evidence that became available during the exposure period, we have substantially modified our previous tentative proposal to provide disclosure and measurement guidance for financial statements presented

4. The concept of differential disclosure is based on the recommendation in the AICPA, *Report of the Committee on Generally Accepted Accounting Principles for Smaller and/or Closely Held Businesses* (New York: AICPA, 1976). The term differential measurement alternatives is used in this report to describe the application of the concept underlying differential disclosure to the use of different measurement rules for the same types of transactions or events based on the criteria of relevance to users and cost-benefit considerations. Under that concept, measurement alternatives would be made available under some standards on an optional basis to some designated classes of entities. The measurement alternatives may range from a flat exemption or suspension, such as those used for the suspension of segment-reporting and earnings-per-share requirements for nonpublic companies, to simply requiring disclosure of relevant information, to allowing simplified alternatives for applying complex measurement rules. Each standard that provided such alternatives would designate the class of entities to which the alternatives were available, and the class of entities may vary from standard to standard. For example, in some situations, the broad class, "nonpublic entities," may be used while in others a narrower class, such as "small nonpublic entities," with "small" defined in the context by stated criteria, may be used.

in conformity with the income tax basis of accounting and our tentative recommendations to the Auditing Standards Board (ASB) and the Accounting and Review Services Committee (ARSC) to reconsider their standards for reports on financial statements presented on that basis. This report does not include the proposed disclosure and measurement guidance. However, we continue to believe that the use of financial statements prepared on a comprehensive basis of accounting other than GAAP (OCBOA) with compilation, review, or audit reports issued under existing standards can be useful to small nonpublic companies in some circumstances.

OCBOA financial statements issued with compilation, review, or audit reports are now used in practice by some entities in place of GAAP financial statements in circumstances in which GAAP financial statements are deemed not to be needed. Broad disclosure guidance is included in the February 1980 auditing interpretation, "Adequacy of Disclosure in Financial Statements Prepared on a Comprehensive Basis of Accounting Other Than Generally Accepted Accounting Principles."⁵ The AICPA *Audit and Accounting Manual* contains illustrative financial statements on the income tax basis as well as other comprehensive bases of accounting.⁶ Statement on Auditing Standards no. 14 includes an illustration of an auditor's report on financial statements prepared on an entity's income tax basis,⁷ and the ARSC staff has issued an interpretation that provides illustrations of compilation and review reports on OCBOA financial statements.⁸ The *Audit and Accounting Manual* also contains illustrations of compilation, review, and audit reports on OCBOA financial statements.⁹

We have reached the following conclusions concerning the use of comprehensive bases of accounting other than GAAP:

- **Small nonpublic entities can gain some measure of relief from accounting standards overload by issuing compiled, reviewed, or audited OCBOA financial statements in accordance with existing disclosure and measurement standards and with the existing reporting requirements for CPAs.**
- **The AICPA staff should expand the illustrations included in its *Audit and Accounting Manual* to cover more of the measurement problems**

5. AICPA, *Professional Standards*, AU sec. 9621.34.

6. AICPA, *Audit and Accounting Manual*, AAM sec. 11,700.

7. AICPA, *Professional Standards*, AU sec. 621.08.

8. See AICPA, Accounting and Review Services Interpretation, "Reporting on a Comprehensive Basis of Accounting Other than Generally Accepted Accounting Principles," Official Releases, *Journal of Accountancy* (Dec. 1982):138, 139.

9. AICPA, *Audit and Accounting Manual*, AAM secs. 10,260.02, 10,400.08, 10,400.09, and 10,500.06.

that are encountered in the use of OCBOA financial statements and to provide additional practical illustrations of the disclosures required by the February 1980 auditing interpretation.

We recommend that the AICPA Board of Directors take the following steps to assist in resolving the problem of accounting standards overload:

1. Urge the FASB in the strongest terms to take effective action on accounting standards overload by—
 - Continuing and, if possible, accelerating its research efforts related to the information needs of users of the financial statements of private and small public companies.
 - Considering simplification of GAAP for all entities as well as both differential disclosure and measurement alternatives for small nonpublic companies based on an evaluation of users' needs and cost-benefit considerations.
 - Adding immediately to its agenda a reconsideration of FASB Statements nos. 13 and 34 and APB Opinion 16 and giving its highest priority to those items and to its reconsideration of APB Opinion 11.
2. Request the AICPA Accounting Standards Executive Committee (AcSEC) in the strongest terms to assist in resolving the problems of accounting standards overload by—
 - Considering the available resources and necessary priorities of the FASB before requesting the FASB to add a new matter to its agenda.
 - Using issue papers as a means of acquainting the profession with accounting problems that are limited in their scope, not just as a means of identifying issues for the FASB to deal with.
 - Assisting the FASB by identifying existing or proposed standards that may be applied in diverse ways (or not at all) by some entities.

We believe the Board of Directors should monitor the actions taken by the FASB and by AcSEC in response to these recommendations. The problem of accounting standards overload has become so significant that if it is not dealt with on a timely basis, our conclusions and recommendations should be reconsidered to determine whether more aggressive action by the Board of Directors is needed.

Basis for Conclusions and Recommendations

In reaching our conclusions and in developing our recommendations, we were influenced by the following considerations.

A significant number of CPAs strongly believe that practitioners who serve small nonpublic entities are hampered by an accounting standards overload that increases the cost of accounting services without providing a corresponding or greater benefit in the form of financial statements with increased utility. The required disclosures in the financial statements and in the notes to the financial statements have become so complex and so numerous that many of the disclosures are not understood and often not even read. The perception of overload is so great that support for existing and future standards may be weakened. This perception is worsened by other requirements that are frequently considered part of accounting standards overload, such as auditing standards, rules of regulatory bodies, income tax rules and regulations, and rules for specialized industries.

The AICPA has given up the authority to establish accounting standards enforceable under its rules of conduct. A move on the AICPA's part to take back, remove, or otherwise restrict the authority of the FASB is likely to damage that organization and, in the process, harm both the public interest and the ability of the private sector to retain the right to set accounting standards.

Small nonpublic entities must be afforded a means of avoiding unnecessarily burdensome and costly accounting standards. The means provided should minimize the potential of confusing users of financial statements and should not weaken the authority and credibility of the FASB.

A solution should not require the establishment of a special body to set new standards that would be costly, duplicate existing bodies, and, in effect, add to the existing accounting standards overload. A solution must now be considered based on differential measurement rules, which distinguish among large and small or public and nonpublic entities on the basis of relevance to users and cost-benefit considerations, in addition to the differential disclosure rules already accepted.

Based on these considerations, we believe the program recommended in this report will make accounting standards more responsive to the needs of all financial statement issuers, preparers, and users.

In our deliberations, we evaluated the following possible approaches to dealing with accounting standards overload:

- No change, retain status quo
- A change from the present concept of a set of unitary GAAP for all business enterprises to two sets of GAAP, thus creating a separate set of GAAP for certain entities, such as small nonpublic businesses
- Changes in GAAP to simplify application to all business enterprises
- Establishing differential disclosure and measurement alternatives
- A change in CPAs' standards for reporting on financial statements
- An alternative to GAAP as an optional basis for presenting financial statements

No Change, Retain Status Quo

We reject retention of the status quo. The evidence is clear that major changes are needed. Accounting standards overload is a major problem with widespread implications for the accounting profession and others interested in financial reporting. The status quo cannot be retained. In a report to the AICPA Board of Directors, the Werner Committee stated:

In the absence of relief by established institutions, the possibility exists that other, undesirable avenues of relief may be sought. They could range from silent disregard of standards, to the abandonment of GAAP . . . , to secession from the Institute. . . .

We have no concrete evidence of an impending threat that members will secede from the Institute. However, the evidence indicates that silent disregard of standards and the abandonment of GAAP are clear and present dangers.

The tenor of many letters of comment and conversations with many CPAs indicate an increasing risk that some standards will, at best, be applied selectively. Research and experience indicate that there are now frequent disclosure and occasional measurement departures in financial statements, especially financial statements of small nonpublic entities.¹⁰ Although the evidence is not clear as to whether those departures from GAAP arise from error or from silent disregard of standards, the complexity of GAAP has reached a point at which the incidence of departures is bound to increase.¹¹ Under those circumstances, present GAAP must be challenged.

We therefore believe that accounting standards overload must be significantly reduced. Too many CPAs and others already view the AICPA and the FASB as not having been responsive to the needs of the users and preparers of financial statements, particularly users and preparers of the financial statements of small nonpublic entities. The status quo should not be permitted to continue. Significant change is needed.

Two Sets of GAAP

We also reject the notion of two sets of GAAP. The evidence indicates that there is insufficient support for that solution among users, preparers,

10. R. D. Nair and Larry E. Rittenberg, "Privately Held Businesses: Is There a Standards Overload?" Professional Notes, *Journal of Accountancy* (Feb. 1983): 82–96. Nair and Rittenberg noted departures from GAAP in their study. A. Rashad Abdel-Khalik noted the same problem in a paper on the results of the study being conducted for the FASB, which he discussed at the 1982 meeting of the American Accounting Association.

11. The disclosure checklists and flowcharts in FASB, *Accounting Standards, Current Text* (Stamford: FASB, 1982) and the disclosure checklists in the AICPA *Audit and Accounting Manual* provide ample evidence of the complexity and costliness of GAAP.

or practitioners. However, there is evidence that a significant minority of practitioners support that solution. The willingness of a sizable minority to accept that approach as a possible solution to accounting standards overload is an indication of how serious the problem has become.

But in addition to our finding that there is insufficient support in the profession and in the business and financial communities for two sets of GAAP, we believe that approach is an undesirable solution that does not have a sound conceptual basis and is one that would pose a threat of dividing the profession. Also, although a second set of GAAP might ease the burden of accounting standards overload on some preparers and practitioners, it would increase the burden on other practitioners and on many users of financial statements.

We believe, however, that viewing the problem of accounting standards overload in terms of two sets of GAAP often serves to confuse and obscure the basic issue of relief from accounting standards overload. "Little GAAP," "GAAP for small businesses," "second-class GAAP," and similar labels are pejorative and heavily laden with emotion. The labels imply that the issue is whether members of the profession and others are willing to accept a lower quality of financial reporting for some segment of business and a lower quality of practice for some segment of the accounting profession. We believe that the issue is not whether two sets of GAAP, one of lower quality than the other, are needed but whether the concept of GAAP should accommodate disclosure and measurement alternatives that may be more cost-effective and still satisfy users' needs. Too often in recent years the emphasis has been on narrowing or eliminating alternatives without considering whether there is a reason to permit alternatives in defined circumstances.

We believe that the FASB is the only body that can provide a solution to accounting standards overload that does not carry the stigma attached to the concept of two sets of GAAP. Some in the profession advocate that the AICPA should set accounting standards for small nonpublic companies and that the FASB's standard-setting authority should be limited to standards for large public companies or for SEC companies. We believe advocacy of that approach at this time would seriously threaten providing a solution within the framework of GAAP and the right to retain the authority for setting accounting standards in the private sector. To divide the authority for setting standards between the FASB and the AICPA would result in all that has been perceived as negative or undesirable in the notion of two sets of GAAP. Thus, we believe the search for a solution to accounting standards overload must be found within the framework of a unitary concept of GAAP. However, if a solution cannot be found within that framework in a reasonable period of time, the notion of the AICPA setting standards for small nonpublic companies, despite its disadvantages, should be reconsidered.

Simplifying GAAP for All Entities

The Committee considered the approach of simplifying GAAP for all entities and concluded that mandated accounting standards are becoming increasingly detailed and complex. We believe that accounting standards should be simplified and made easier for all entities to apply. Preparers and CPAs should be given more latitude to exercise judgment. To the extent feasible, standards should be broad principles dealing with the substance of transactions and events and should be flexible enough to allow different implementation in different circumstances. Standards should not be written to deal with accounting practices designed to obscure the substance of transactions or to serve the needs of the profession to curb unethical practitioners. Appropriate disciplinary bodies should be used to achieve those objectives.

The Committee's recommendation that the FASB should promptly reconsider and act on certain accounting standards widely perceived to be unnecessarily burdensome and costly, particularly for small nonpublic entities, is based on the premise that the accounting issues dealt with in those standards can be addressed with greater simplicity and flexibility using the approach recommended on page 3 of this report. To the extent that these and other existing standards can be simplified and to the extent that future standards do not require detailed and complex procedures, considerable relief from accounting standards overload can be achieved for all entities. However, our recommendations for actions by the FASB are not limited to the simplification of standards; they also address the need for differential disclosure and measurement alternatives within GAAP for small nonpublic entities.

Differential Disclosure and Measurement Alternatives

An approach based on differential disclosure and measurement alternatives for small nonpublic enterprises is recommended in this report. In its review of existing standards and in its development of measurement standards for financial statements, the FASB should explicitly consider relevance to users and cost-benefit considerations with respect to small nonpublic entities. The solution to accounting standards overload for those entities lies in acknowledging the fact that since the needs and the cost environment of all businesses are not alike, an objective application of two basic standard-setting criteria—relevance to users and cost-benefit considerations—could result in accounting requirements for small nonpublic entities that are different from those for large public entities.

The FASB's conceptual framework is grounded in users' needs and provides a sufficient basis for considering relevance to users and cost-

benefit factors.¹² Statement of Financial Accounting Concepts no. 2 states:

The optimal information for one user will not be optimal for another. Consequently, the Board, which must try to cater to many different users while considering the burdens placed on those who have to provide information, constantly treads a fine line between requiring disclosure of too much information and requiring too little.¹³

Also, the statement gives equal weight to "materiality" and "costs and benefits," one as a threshold for recognition and the other as a pervasive constraint.¹⁴

The commonly held view that GAAP constitutes a single body of rules that must be applied in precisely the same manner by all enterprises makes it difficult to make progress in providing relief from the burden of accounting standards overload on small nonpublic entities. However, existing GAAP contains ample precedents for differential disclosure and measurement alternatives based on differences in underlying facts and circumstances.

Under Accounting Research Bulletin no. 43, chapter 7B, the method by which public companies are required to account for stock dividends differs from the method required for closely held companies. Chapter 7B, paragraph 12, states:

In cases of closely-held companies, it is to be presumed that the intimate knowledge of the corporations' affairs possessed by their shareholders would preclude any such implications and possible constructions as are referred to in paragraph 10. In such cases, the committee believes that considerations of public policy do not arise and that there is no need to capitalize earned surplus other than to meet legal requirements.¹⁵

FASB Statement no. 21 suspended the requirements of APB Opinion no. 15, *Earnings Per Share*, and FASB Statement no. 14, *Financial Reporting for Segments of a Business Enterprise*, for nonpublic enterprises.¹⁶ The literature contains many other differences, ranging from

12. In Statement of Financial Accounting Concepts no. 1, *Objectives of Financial Reporting by Business Enterprises*, par. 5 (Stamford: FASB, 1980), the objectives are stated broadly in terms of users' needs and are not restricted to information communicated by financial statements.

13. Statement of Financial Accounting Concepts no. 2, *Qualitative Characteristics of Accounting Information*, par. 36 (Stamford: FASB, 1980).

14. *Ibid.*, pars. 133 through 144.

15. Accounting Research Bulletin no. 43, *Stock Dividends and Stock Split-Ups in Accounting Standards, Original Pronouncements*, ch. 7B, par. 12 (Stamford: FASB, 1982).

16. Statement of Financial Accounting Standards no. 21, *Suspension of the Reporting of Earnings Per Share and Segment Information by Nonpublic Enterprises*, an amendment of APB Opinion 15 and FASB Statement no. 14 (Stamford: FASB, 1978).

differences that are viewed as free alternatives (depreciation methods, inventory costing methods) to differences based on industries (accounting for marketable securities and for investments), to differences based on whether an enterprise is regulated or unregulated, a profit or not-for-profit organization, or a government or nongovernment organization. However, efforts to make progress in simplifying a unified body of GAAP to recognize relevance to users and cost-benefit considerations for small nonpublic entities have too often been hamstrung by the fear of being perceived as moving to two sets of GAAP, one set inferior to the other; and precedents for differential measurement alternatives are usually ignored.

We believe that the profession and the FASB should not be hampered in developing differential measurement and disclosure alternatives out of fear that they will be misconstrued as two sets of GAAP. The FASB should take the lead in developing and popularizing a flexible concept of GAAP that is consistent with its evolving conceptual framework. CPAs should avoid emotion-laden labels. The AICPA should speak with one voice on the accounting standards overload issue and take a leading advocacy role in support of reasonable distinctions based on underlying facts and circumstances.

The extension of differential measurement alternatives to serve the specialized needs of small nonpublic companies is now needed. The FASB has already adopted such an approach for some disclosures; certain disclosures are now required only in the financial statements of public companies. However, we believe that in developing accounting standards the FASB tends to give too much weight to the relevance of the information to the needs of users of the financial statements of large public entities, and too little weight to the relevance of the information to the needs of users of financial statements of small nonpublic entities and the related cost-benefit considerations. There is no reason why the approach used to resolve the segment-reporting and earnings-per-share questions cannot be used for selected measurement standards, with a general application for certain types of entities and alternatives on an optional basis for others. The advocated approach is not two sets of GAAP, any more than the distinctions that already exist represent different sets of GAAP.

If the FASB decides that certain standards are needed for large or public entities but do not meet the relevance and cost-benefit criteria for small nonpublic entities, it should develop a means to provide exemptions from the standards for small nonpublic entities, or to provide less onerous measurement alternatives for such entities. For example, the FASB could provide an exemption or make such a standard optional for certain companies as it did in FASB Statement no. 21. Under such an approach, the

FASB should determine the basis of the exemption separately for each standard, for example, public versus private or a size test based on asset values.

A Change in CPAs' Reporting Standards

We considered the possibility that a change in the language of CPAs' reports for audits, reviews, and compilations could alleviate accounting standards overload. The change considered would permit CPAs to report in a less negative way when financial statements contain departures from GAAP.

We rejected that approach. We do not believe that the present reporting requirements for financial statements that contain departures from GAAP are burdensome as some have alleged. The existing reporting requirements seem to be necessary to communicate to users the degree of responsibility assumed by CPAs and the level of assurance provided. Furthermore, changes in the standards for CPAs' reports on such financial statements might expose CPAs to greater liability, confuse users as to the significance of GAAP, and weaken respect for CPAs' reports.

The view that less negative reporting on financial statements that contain GAAP departures would help to relieve accounting standards overload is evidence that many users, preparers, and CPAs have an overly negative view of CPA reports that are modified to explain clearly the nature of the CPA's engagement, the level of responsibility assumed, and the level of assurance provided. This suggests that the profession has a communication problem and that there is a need to educate concerned parties about the nature and purpose of CPA reports. The nature of an engagement, the needs of the client, and the identity of the user of the client's financial statements may suggest that a modified opinion, or even an adverse opinion or a disclaimer of an opinion, would be appropriate without impairing the value of the services the CPA rendered or the usefulness of the results. We therefore encourage the AICPA to continue its efforts to educate the public about the nature of CPA reports on financial statements and the purposes served by the language of those reports.

We also note that standards for compilation and review engagements afford CPAs considerable flexibility in reporting on compiled or reviewed financial statements. The existing standards for compilation and review engagements do not require the CPA to disclose the effects of departures from GAAP in his report if management has not determined those effects. The effects must be disclosed only if they are known as a result of the CPA's limited procedures. Moreover, nonpublic entities have available to them the option of issuing compiled financial statements that omit

substantially all disclosures. The availability of such alternatives to CPAs and to small nonpublic entities has helped to relieve the burden of accounting standards overload.

Optional Alternatives to GAAP

We considered the possibility of identifying a comprehensive basis of accounting other than GAAP to be used as an alternative to GAAP at the option of the preparer of financial statements for small nonpublic entities. Three possibilities were evaluated:

1. A new basic accounting method (BAM)
2. The cash or modified cash basis
3. The income tax basis

We believe that OCBOA financial statements can provide some relief to small nonpublic entities in some circumstances (see discussion on page 5). However, none of the three bases evaluated, including, as discussed below, the income tax basis of accounting, can meet the objectives of financial reporting to present fairly the financial position and results of operations of an enterprise. Therefore, we concluded that use of OCBOA financial statements cannot provide a broad, long-term solution to the accounting standards overload problem. We have concluded that the cost of issuing additional official guidance for one or more of those accounting bases—including the possibility of creating new overloads—outweighs the benefits.

We have also specifically rejected the notion of a new BAM because—

- It would imply that it included the essentials of GAAP, but it would have to permit significant departures from the measurement principles of GAAP to deal with the problem effectively and, therefore, would be likely to confuse users and undermine the authority of GAAP.
- It would add to accounting standards overload by creating new requirements in addition to GAAP, income tax rules and regulations, and so forth.
- It would require readdressing every major measurement issue in GAAP. Gaining agreement on the answers would be time-consuming, with no assurance of ultimate success, and it would be costly.
- It could be viewed as a significant criticism of and challenge to the FASB.
- It might require a standing body to consider each new FASB pronouncement to determine whether the pronouncement should be incorporated into BAM.
- Although in form it could be treated as a comprehensive basis of

accounting other than GAAP, in substance it would be or evolve into a second set of GAAP for specified entities.

Income Tax Basis Financial Statements

In its tentative conclusions, the Committee recommended and proposed disclosure and measurement guidance for financial statements presented on the income tax basis of accounting and recommended that the ASB and the ARSC reconsider and modify their requirements for audit, compilation, and review reports on income tax basis financial statements. Because of the perspectives gained from the comments on the discussion paper, other evidence obtained during the exposure period, and the many implementation issues the guidance would raise (see Appendix B), we modified those tentative conclusions and recommendations and are not issuing the proposed guidance. However, as set forth in the section of this report on recommended AICPA action, we believe that the issuance, in accordance with existing reporting standards, of compiled, reviewed, or audited OCBOA financial statements, including income tax basis financial statements, can help to alleviate the burden of accounting standards overload for small nonpublic entities. This report recommends that the AICPA provide additional guidance in its *Audit and Accounting Manual* to facilitate the use of those methods of accounting and reporting in circumstances in which GAAP financial statements are not needed (see page 5).

Our tentative recommendations to the ASB and the ARSC were based on the view that the same message could be conveyed in a more positive manner. Those recommendations are not included in this report because we have concluded that if income tax basis financial statements are appropriate in a given situation, the CPA's present reporting standards do not preclude their use.

Summation

We believe that the conclusions and recommendations in this report represent a realistic program for beginning to reduce accounting standards overload. The program is based on an assessment of the needs of all those involved or interested in the financial reporting process and on the recognition that the CPA is caught in the middle between the demands of professional standards and the discontent of small business clients with the burdens imposed by accounting standards overload. It recognizes that the FASB is beginning to consider the financial reporting needs of small businesses and the users of their financial statements. The FASB is devoting significant resources to relevant research. That research ef-

fort, expanded by the independent research efforts of other organizations and individuals, should continue.

The FASB needs the positive and constructive support of all of its constituencies, including preparers, users, and practitioners. The FASB is often confronted with conflicting demands from its various constituencies, which have made it difficult to deal with the escalating problem of accounting standards overload. Financial statement users and representatives of those users typically ask more from financial statements than they are given. The demands from users often seem insatiable. CPAs demand detailed standards to serve as rigid rules against which to test the judgment of preparers in the application of accounting standards. Moreover, the standard-setting process has for a long time been driven by the desire and the continuing demand to eliminate alternatives not justified by differences in circumstances. It has begun to appear as if all alternatives *must* be eliminated *regardless of differences in circumstances*. It is time to begin to redress the imbalance.

Preparers, users, and practitioners as well as standard-setting bodies have been mesmerized into inaction by the fear that alternatives based on distinctions between classes of entities would mean two sets of GAAP. The espousal of a unitary concept of GAAP, which is the concept underlying the program recommended in this report, has become distorted into a position that permits no differences between classes of entities in the application of measurement standards, although a few differences in disclosure standards are allowed. The program recommended in this report rests on the premise that a unitary concept of *generally accepted accounting principles* as mandated by standard-setting bodies can embrace alternatives that can be used at the practitioner's option in selected areas based on evaluation of users' needs and cost-benefit considerations. It is not a wholly new approach. Some standards deemed to deal only with disclosure matters already permit such alternatives; in some of those areas, the line between disclosure and measurement is nebulous at best. To make such a program work, the FASB should determine the applicability of its standards and the bases of distinctions among classes of entities; such distinctions should not be left to the judgment of individual preparers and accountants based on a case-by-case application of subjective criteria. We believe that all those involved or interested in the financial reporting process have a vested interest in making the program recommended in this report work.

Qualifying and Dissenting Views

This report was adopted by the affirmative votes of six members of the Committee, two of whom, Messrs. Israeloff and Nest, assented with qualifications. Mr. Luton dissented.

Mr. Israeloff qualifies his assent to the issuance of this report because he believes the Committee should have provided disclosure and measurement guidance for the income tax basis of accounting and should have requested the ASB and the ARSC to modify their standards for reports on income tax basis financial statements. He disagrees with the Committee's "evaluation of the comments on the discussion paper and other evidence," indicated on pages 4 and 5 of this report as the basis for modifying the Committee's previous tentative conclusions and recommendations on those matters.

Mr. Israeloff agrees with the Committee that there are circumstances in which income tax basis financial statements can provide useful and cost-effective information and can provide some relief from accounting standards overload. Providing disclosure and measurement guidance for such statements would, in his view, highlight the acceptability of such statements in circumstances in which they are deemed to be useful and cost-effective and would provide needed professional uniformity for their presentation.

Mr. Israeloff disagrees with the implication in the report that the existing disclosure guidance for income tax basis financial statements is sufficient because there is no specific guidance in authoritative literature on information to be disclosed in financial statements, particularly in the notes to the financial statements, prepared on a comprehensive basis of accounting other than GAAP. Further, the existing literature states that the accountant should look to GAAP in evaluating the appropriateness of disclosures in such financial statements, which, in his view, provides no relief from accounting standards overload. The guidance proposed by the Committee in its discussion paper would have rectified this situation.

Mr. Israeloff also believes that the CPA's report on income tax basis financial statements under existing reporting standards is so negative in tone that it significantly restricts the use of such statements as a means for small nonpublic entities to cope with accounting standards overload. In Mr. Israeloff's view, disclosure of the basis of presentation in the CPA's report and in the financial statements is adequate. He believes there should be no need to state that the statements are not intended to present financial position and results of operations in conformity with GAAP or to disclose how the presentation differs from GAAP either in the notes to the financial statements or in the CPA's report.

Mr. Nest qualifies his assent to the issuance of this report because he believes the conclusions and recommendations are not an adequate response to the Committee's charge. He believes the Committee's report documents the case for action to relieve the burdens of accounting standards overload but does nothing substantial to provide relief except, once again, to urge the FASB to act on the problem and to add certain matters to its ever-growing agenda.

In support of his opinion, Mr. Nest notes that the report still expresses the view that income tax basis financial statements can provide some relief from accounting standards overload. However, he believes that to make such relief widely available to small nonpublic companies, the Committee should have dealt with the objections to its tentative conclusions and recommendations on income tax basis financial statements rather than basically dropping the recommendations and the proposed guidance in their entirety. Mr. Nest believes that, if necessary, the revised recommendations could have included a forthright statement on the limited circumstances in which income tax basis financial statements would be useful.

Mr. Luton dissents to the issuance of this report because he believes the solution to the accounting standards overload problem requires that the AICPA reclaim the authority to establish accounting standards. He believes the FASB has created more problems than it has solved and that this report will allow the FASB to continue on its established course, which is the same as accepting the status quo. He cites as reasons for his view the FASB's concern about public entities, the influence of the SEC on the FASB, the absence of individuals with small business or small CPA firm backgrounds on the FASB, the structure of the FASB as a full-time standard-setting body, and the past performance of the FASB.

Mr. Luton believes the FASB has shown that it is primarily concerned with public entities and is strongly influenced by the SEC. Small nonpublic businesses, in Mr. Luton's view, have no representation on the FASB and no organized means to influence the development of its standards, yet they must still comply with those standards. He believes that the FASB has not dealt and is not likely to deal effectively with the basic differences between public and nonpublic entities because it has a big business or big CPA firm perspective. Accordingly, it is not likely to be able to serve the needs of small nonpublic businesses and small accounting firms.

Mr. Luton believes that expecting a full-time board to produce fewer standards than it has in the past is unrealistic. On the contrary, he believes the number of standards is likely to multiply and standards are likely to become increasingly more complex and impracticable. He believes that except for its suspension for nonpublic companies of the segment-reporting and earnings-per-share requirements, the FASB has largely ignored the differential disclosure solution recommended by the Werner Committee as well as its commitment in Statement of Financial Accounting Concepts no. 2 to consider relevance to users and cost-benefit factors in the standard-setting process. In Mr. Luton's view, a long-term study of the problem is not responsive to the needs of the profession; the survival of a unified profession demands immediate action with continuing attention to the problem.

APPENDIX A

Charge to the Special Committee on Accounting Standards Overload

The AICPA Board of Directors gave the Special Committee on Accounting Standards Overload this charge:

To study accounting standards overload and to consider alternative means of providing relief from accounting standards which are found not to be cost effective, particularly for small, closely held businesses, and to report thereon to the board of directors.

In developing its recommendations, the special committee should—

- Discuss with representatives of the FASB progress being made on the board's project on "Financial Statements and Other Means of Financial Reporting—Small and Closely Held Business Enterprises."
- Consider the August 1976 AICPA document, *Report of the Committee on Generally Accepted Accounting Principles for Smaller and/or Closely Held Businesses*.
- Consider existing means for obtaining relief from the requirements of GAAP—the availability and usefulness of "other comprehensive bases of accounting" (SAS 14) and of a special compilation report for financial statements that omit substantially all of the disclosures required by GAAP (SSARS 1).
- Consider when and how to solicit views from users of the financial statements of small and closely held businesses.
- Expose its recommendations to the public for comment.

The committee's report should discuss the alternative means of providing relief that it has identified and its reasons for adopting or rejecting each alternative. Its report should be in detail sufficient to enable the AICPA Board of Directors to implement the recommendations without further work. For example, if the committee concludes that uniform guidance is needed with respect to another comprehensive basis of accounting, whether existing (for example, modified cash basis) or new (such as modified accrual basis), it should provide that guidance. Also, if the committee concludes that there is a need to deal with this subject on an ongoing basis, it should recommend an appropriate structure for that purpose.

Description of the Committee's Proceedings and of Evidence Considered

During 1981, the Committee considered the implications of its charge; identified the nature, dimensions, and causes of accounting standards overload; and developed tentative conclusions and recommendations on initiatives to provide relief from accounting standards overload, particularly for small and closely held businesses and the CPAs who serve those businesses. The Committee closely followed the simultaneous initiatives and actions of the FASB to identify the dimensions of the problem from the perspective of private and small public companies and to formulate a solution. The senior FASB staff member in charge of that project attended two Committee meetings and reported on concurrent developments in that effort, including the preparation of the FASB's Invitation to Comment¹ and its continuing effort to sponsor and to encourage others to sponsor research on the subject.² Finally, the problem and the Committee's tentative findings were discussed with the AICPA Board of Directors and with AcSEC.

Issuance and Distribution of the Discussion Paper

On December 23, 1981, the Committee issued for public comment through May 31, 1982, a discussion paper with its tentative conclusions and recommendations.³ The discussion paper was distributed to the following groups:

- All practice offices of CPA firms
- Members of AICPA Council and chairpersons of AICPA technical committees
- Presidents, executive directors, and selected committee chairpersons of state society chapters
- Organizations concerned with regulatory, supervisory, or public disclosure of financial activities
- Persons who requested copies

In the discussion paper, which had as a premise the need for action to alleviate accounting standards overload, the Committee—

- Analyzed the implications of its charge.
- Presented a comprehensive discussion of the scope, causes, and results of accounting standards overload.

1. FASB Invitation to Comment, *Financial Reporting by Private and Small Public Companies* (Stamford: FASB, 1981).

2. The FASB is sponsoring a series of research studies on the subject and expects to issue the results in 1983. The FASB is also encouraging other organizations to sponsor research on the subject.

3. AICPA, *Tentative Conclusions and Recommendations of the Special Committee on Accounting Standards Overload* (New York: AICPA, 1981).

- Described the initiatives and actions of the AICPA and the FASB to deal with the problem over the years.
- Identified the range of continuing problems, including certain standards alleged to be unnecessarily burdensome, particularly to small nonpublic companies.
- Evaluated several possible approaches to providing relief.
- Discussed implementation of the recommended actions, including the presentation of tentative disclosure and measurement guidance to provide a framework for wider use of financial statements prepared on the income tax basis of accounting.

The Committee presented these major tentative recommendations for actions to relieve accounting standards overload:

- The FASB should be urged to reconsider and act on certain accounting standards that are widely perceived as unnecessarily burdensome and costly, particularly for small nonpublic companies.
- Guidance should be provided for CPAs who are asked to assist their clients in preparing financial statements presented in conformity with the income tax basis of accounting. The guidance included in the discussion paper was designed to increase consistency among entities that chose to report on the income tax basis of accounting.
- The ASB and the ARSC should be urged to reconsider their standards for reports on financial statements presented in conformity with the income tax basis of accounting.

The Committee has reconsidered those recommendations in light of the comments received on the discussion paper and, as set forth in this report, has revised and amplified them.

Comments Received on the Discussion Paper

The Committee received 299 letters of comment on its discussion paper. Of the responses, 238 were from practicing CPAs (196 from small firms, 31 from medium-sized firms, and 11 from large firms); 18 were from professional accounting organizations, primarily committees of state societies; 8 were from industry; 2 were from users; 15 were from college students (not included in summary on page 22); and 18 were from various other individuals and groups, including components of the AICPA and representatives of other bodies concerned with standard-setting. The following AICPA components and other bodies concerned with standard-setting or their representatives responded:

- The Accounting Standards Executive Committee
- The Accounting and Review Services Committee
- The Auditing Standards Board
- The Technical Issues Committee of the Private Companies Practice Section

- The chairman of the Professional Ethics Executive Committee
- The Robert Morris Associates
- The chairman of the International Accounting Standards Committee
- The staff of the Financial Accounting Standards Board
- The deputy chief accountant of the Securities and Exchange Commission

The respondents overwhelmingly supported the Committee's conclusion that accounting standards overload is a real and pressing problem that requires vigorous and expeditious action to provide meaningful relief.

The respondents, in varying degrees and for different reasons, generally expressed overall support for the Committee's tentative recommendations to relieve accounting standards overload as the following summary indicates.

<u>FASB Action</u>	<u>Support</u>	<u>Oppose</u>	<u>No Explicit Position Taken</u>
Small Firms	88	27	81
Medium-sized firms	18	4	9
Large firms	7	4	0
Accounting organizations	12	1	5
All others	11	5	12
Totals	<u>136</u>	<u>41</u>	<u>107</u>
	<u>48%</u>	<u>14%</u>	<u>38%</u>

Guidance on the Income
Tax Basis of Accounting

Small firms	111	57	28
Medium-sized firms	18	11	2
Large firms	5	6	0
Accounting organizations	4	12	2
All others	8	12	8
Totals	<u>146</u>	<u>98</u>	<u>40</u>
	<u>51%</u>	<u>35%</u>	<u>14%</u>

ASB-ARSC Actions

Small firms	101	52	43
Medium-sized firms	17	11	3
Large firms	4	6	1
Accounting organizations	3	12	3
All others	7	14	7
Totals	<u>132</u>	<u>95</u>	<u>57</u>
	<u>46%</u>	<u>34%</u>	<u>20%</u>

The recommendation for action by the FASB drew less attention than the recommendation to provide guidance for the use of the income tax basis of accounting. Many respondents (38 percent), particularly from small firms, did not comment on the recommendation for FASB action. Many respondents, again especially from small firms, indicated general overall approval of the discussion paper but commented only on the recommendations concerning the income tax basis.

Among respondents who took an explicit position on the recommendations for action by the FASB, 77 percent supported it. Those opposing it gave reasons such as—

- There is no standards overload.
- The FASB is already addressing the issue through its Invitation to Comment and its sponsored research.
- There should be no distinction in measurement principles for small companies.
- The authority of the FASB should not be impaired.

The recommendation to provide guidance for the use of the income tax basis of accounting drew the attention of most of the respondents. Respondents supported the recommendation (support among small firms was about two to one) for reasons such as—

- There is a need to provide a framework for the income tax basis of accounting.
- The income tax basis of accounting provides an alternative to GAAP for small companies.
- The income tax basis of accounting will serve the needs of users of the financial statements of small companies.

Some who supported the recommendation seem to have misinterpreted its intent and seem to have viewed it as a proposal to use the income tax basis as an alternative set of GAAP for small companies.

Respondents who opposed the recommendation to provide guidance for the use of the income tax basis raised several issues concerning the implementation of the proposal, some of which also seemed to be based on a misunderstanding. Among the reasons given for opposition were—

- Promoting wider use of the income tax basis would surrender standard-setting for a significant segment of financial reporting to the government.
- Promoting wider use of the income tax basis in the United States would hamper efforts in other countries to eliminate the influence of tax accounting on financial reporting standards, and it would impede efforts to keep the responsibility for setting financial reporting standards in the private sector.
- Promoting wider use of the income tax basis would not address the problem of accounting standards overload.
- The proposed disclosure and measurement guidance for income tax basis financial statements would add to accounting standards overload.
- The CPA's role as a tax practitioner would conflict with his role in reporting

on income tax basis financial statements. The CPA might be unwilling to take advocacy positions on tax matters.

- Reporting on income tax basis financial statements would expose CPAs to increased liability.
- Income tax accounting rules provide an inappropriate basis for financial statements because the rules are complex, constantly changing, and permit diverse methods of reporting.
- Income tax laws and regulations are designed to achieve various social and economic objectives, not to measure financial position and results of operations.
- The proposal would establish the income tax basis as second-class GAAP for small companies.
- Promoting wider use of income tax basis financial statements would make it more difficult to restrict the assurance function to CPAs under state laws.
- A new standard-setting body would be needed to maintain disclosure and measurement standards for income tax basis financial statements.
- To the extent that income tax basis statements are appropriate, they can now be covered by special reports under SAS no. 14.

Several who opposed the recommendation on the income tax basis as presented in the discussion paper agreed, however, that additional disclosure and measurement guidance would be desirable to provide a better framework, not only for income tax basis financial statements, but also for financial statements prepared on the other comprehensive bases of accounting described in SAS no. 14.

The recommendation for the ASB and the ARSC to reconsider their standards for reporting on income tax basis financial statements was generally supported by those who also supported the recommendation to provide disclosure and measurement guidance for the use of income tax basis financial statements. However, some supported one and not the other. Those who opposed the recommendations for ASB-ARSC actions generally believed that the present reporting requirements under SAS no. 14 were not onerous and were essential to maintain GAAP as the benchmark for financial statements.

Other Evidence Considered

During the exposure period of the discussion paper, Committee members and staff received helpful comments and reactions to the discussion paper from their participation in several national and local conferences and seminars that addressed accounting standards overload, such as the National Conference of the AICPA Private Companies Practice Section, the AICPA Local Practitioners' Seminars, state society meetings, the 1982 annual meeting of the American Accounting Association, and the Ross Institute's 1982 Roundtable on Financial Reporting by Private and Small Companies and Accounting Standards Overload.⁴

4. The results of the conferences and seminars were made available to the Committee in reports or transcripts of the proceedings. See, e.g., Ross Institute, *Transcript of Proceedings of the Ross Institute's Roundtable on Financial Reporting by Private and Small Companies and Accounting Standards Overload* (New York University, May 14, 1982).

The Committee also considered the preliminary results and analysis of the responses to the FASB Invitation to Comment, and of FASB-sponsored research, the reactions to published articles,⁵ and the results of empirical research studies conducted by individuals.⁶ The evidence from all those sources supports the Committee's conclusion that there is an accounting standards overload and that immediate action to provide relief is imperative.

5. See, e.g., Thomas P. Kelley, "Accounting Standards Overload—Time for Action?" *CPA Journal* (May 1982): 10–17 and Gerald W. Hepp and Thomas W. McRae, "Accounting Standards Overload: Relief Is Needed," *Journal of Accountancy* (May 1982): 52–62.

6. One study considered was R. D. Nair and Larry E. Rittenberg, "Privately Held Businesses: Is There a Standards Overload?" Professional Notes, *Journal of Accountancy* (Feb. 1983): 82–96.

APPENDIX C

Accounting Standards Executive Committee's Comments on the Report

AICPA

American Institute of Certified Public Accountants

1211 Avenue of the Americas, New York, New York 10036 (212) 575-6200

February 16, 1983

Rholan Larson, CPA
Chairman of the Board
American Institute of
Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036

Dear Rholan:

Attached are AcSEC's comments to the Board of Directors on the draft final report of the Special Committee on Accounting Standards Overload. Because the concept of differential measurement alternatives was emphasized in the draft final report but was not emphasized in the exposure draft, AcSEC suggests that the board consider obtaining the views of the AICPA membership on that subject.

I look forward to discussing the report with you at the Board meeting in February.

Sincerely,

Handwritten signature of Roger Cason in cursive script.

Roger Cason
Chairman
Accounting Standards
Executive Committee

RC:df
Attachment

February 16, 1983

The Board of Directors
American Institute of
Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036

Members of the Board:

The Accounting Standards Executive Committee (AcSEC) has reviewed the draft final report of the Special Committee on Accounting Standards Overload and has prepared these comments.

AcSEC shares many of the concerns of the special committee. We believe that the accounting standards overload affects not only small enterprises, but all enterprises, large and small, the independent accountants who serve them, and the users of financial statements. We believe that the accounting standards overload problem can be reduced and we discuss in this letter AcSEC's recommendations for reducing the problem.

However, tradeoffs may be required, because the objectives of improved financial reporting and increased comparability of financial statements may conflict with the objective of reducing accounting standards overload. Accordingly, the AICPA should not cause its members to believe that either the overload or the perception of the overload can be reduced sufficiently to satisfy everyone. A greater effort may therefore be needed by the FASB and the AICPA to explain simply and concisely why a given standard is necessary, why it is sound, and how its benefits justify its cost.

In considering the problem and the draft final report, AcSEC addressed five major topics:

- o overcomplexity of accounting standards,
- o accounting standards versus accounting guidance,
- o packaging and retrieval of accounting standards and accounting guidance,
- o differential measurement, and
- o AcSEC's role in combating accounting standards overload.

Overcomplexity of Accounting Standards

AcSEC believes that the present overcomplexity of many accounting pronouncements is a major cause of the accounting standards

overload and that eliminating the overcomplexity would be the single most effective way to reduce the overload. An overcomplex accounting standard is one that is unnecessarily difficult to understand and unnecessarily difficult to apply.

We acknowledge that complexities in the economic activities portrayed in financial statements make some complexity in accounting standards necessary. Nevertheless, we believe that accounting standards in complex areas are currently more complex than necessary and that there are accounting standards in many other areas that are more complex than the economic activities they portray.

The draft final report asks for a reduction of detailed rules and for permitting greater flexibility and more room for judgment in applying financial accounting standards as means of reducing the overload. However, a complex standard generally makes detailed guidance in its application necessary. Therefore, not providing detailed guidance and permitting flexibility and more room for judgment would not necessarily ease the problem. On the contrary, it could create time consuming questions about when and how to apply the standard. The pleas for detailed guidance are not a cause of the accounting standards overload. They are a natural and inevitable result of the present overcomplexity that to a considerable extent causes the overload.

AcSEC believes that elimination of unnecessary complexity should be an essential criterion by which alternative solutions to accounting standards issues should be evaluated. These are among the ways to satisfy that criterion:

- o selection of one of several alternative solutions to an issue rather than creating a compromise among alternatives, which frequently results in unnecessary complexity,
- o selection of the less complex of alternatives of relatively equal conceptual merit, based on the presumption that the benefits of less complex alternatives exceed their costs more than the benefits of more complex alternatives exceed their costs, and
- o selection of a less complex alternative rather than a more complex one with clear conceptual superiority, if the costs of the more complex alternative exceed its benefits.

The cost benefit analyses should consider the costs and benefits to preparers and users of financial statements as well as to independent accountants and should consider the special problems of small, nonpublic companies.

Complexity in accounting standards covering complex activities can be reduced. One way might be to segment the issues related to the activities and develop one relatively less complex standard for circumstances that most enterprises encounter and another standard for the more complex areas relatively few enterprises encounter.

Ease of understanding the standards has often been sacrificed in striving to be precise and avoid ambiguity, and that has added to their complexity. The standards can and should be written in a simpler style and with simpler language so that they would be easier to understand, without making the standards less effective.

Elimination of unnecessary complexity should therefore be a primary objective of those involved in the accounting standards setting process. They should carefully consider and critically appraise all solutions to issues that would be hard to understand, would be hard to apply, would necessitate detailed guidance and interpretation, or may require frequent amendment. AcSEC believes that many of the present overcomplex standards would have been much less complex had that objective been kept in mind when the issues they cover were addressed, with little or no reduction in the quality of financial reporting.

Accounting Standards Versus Accounting Guidance

AcSEC believes that the growing number of standards enforceable under Ethics Rule 203 contributes to the perception of an accounting standards overload. AcSEC has written its views on that subject to the FASB Task Force on Timely Financial Reporting Guidance.

Packaging and Retrieval

The FASB's present practice of issuing all its standards in a single series contributes unnecessarily to a perception of an overload. Regardless of whether some of the guidance will be issued so that it does not come under Rule 203 of the AICPA Code of Professional Ethics, there should be separate series of guidance. Further, issuing standards that amend other standards adds unnecessarily to the number of standards issued. Instead, the standards that are amended should be reissued giving effect to the amendments. (Australia, Canada, and the U.K. issue only amended standards.) Seventy one standards (as of this writing) seems like a greater overload than, say

- o twenty statements of financial accounting standards, incorporating all amendments to date;
- o twenty statements of specialized industry financial accounting standards or guidance, incorporating all amendments to date; and
- o thirty one memorandums of amendments to financial accounting standards, available on request.

Those involved in applying the guidance should be made aware that they should be familiar with the first group of statements of financial accounting standards and that they can have easy access to the statements of specialized industry standards or guidance but need not study them unless they need to apply them. FASB and AICPA retrieval and advice mechanisms should be improved so that those who need guidance in specific circumstances will know it is available and will feel it is easy and inexpensive to obtain.

Differential Measurement Alternatives

AcSEC believes the Board of Directors should consider the special committee's recommendation that the FASB be asked to contemplate differential measurement alternatives for small, nonpublic companies, based on evaluation of user needs and cost benefit considerations. However, based on available evidence, AcSEC is not convinced that differential measurement is a feasible and effective way to reduce the overload. Research to date indicates, as the special committee notes, that few if any want two sets of GAAP, and experience indicates that users oppose a proliferation of alternatives. In fact, a principal purpose of accounting standard setting is to reduce alternatives. Further, AcSEC is concerned that differential measurement might aggravate the overload problem, because practitioners would have to learn two sets of rules and would have to know which standards have alternatives and which do not and the circumstances under which each alternative is available or should be used.

Differential measurement represents a substantial departure from present accounting standard setting. For that reason, AcSEC believes a movement toward differential measurement should be cautious and should be supported by strong evidence that the reduction in cost to preparers and their independent accountants outweighs the loss of benefit to users. The FASB's current project on "Financial Reporting by Private and Small Public Companies" may provide helpful input on that issue, and AcSEC believes that a decision on differential measurement should incorporate the results of that project.

In any event, AcSEC believes that the attractiveness of differential measurement is due to the overcomplexity of accounting standards and that reduction in their complexity for all enterprises would be more effective in relieving the problem than differential measurement.

AcSEC's Role in Combating Accounting Standards Overload

AcSEC supports the special committee's view that a solution to the overload problem should be found within the framework of a unitary concept of GAAP and that the FASB should be the only accounting standard setting body. In responding to requests from AICPA members for guidance on emerging practice problems, AcSEC continues to be willing to provide guidance not subject to Rule 203.

Before FASB Statement of Financial Accounting Standards No. 32, "Specialized Accounting and Reporting Principles and Practices in AICPA Statements of Position and Guides on Accounting and Auditing Matters," was issued, AcSEC provided guidance to AICPA members in its statements of position, without adding to the FASB agenda and ultimately to standards enforceable under Rule 203. Since then, AcSEC's role has been limited mostly to developing issue papers, whose ultimate disposition is in the hands of the FASB, and responding to FASB discussion memorandums and exposure drafts. AcSEC would be pleased to participate in discussions to modify its current role.

Other Comments

AcSEC supports these recommendations of the special committee:

- o The FASB is the appropriate body to take effective action, both in the short term and the long term, to provide relief from accounting standards overload. [see page 3]
- o The FASB should explicitly and specifically consider the information needs of the users of financial statements of small, nonpublic entities and the costs and benefits of developing the information with the objective of providing, within the framework of a unified GAAP, differential disclosure alternatives based on the criteria in the Werner Committee Report. [see page 3]
- o With the objective of reducing complexity in existing standards, the FASB should reexamine -

FASB Statement No. 13 on accounting for leases and its amendments and interpretations,

the pro forma disclosures required by APB Opinion 16 on business combinations, and

FASB Statement No. 34 on interest capitalization,

and it should give high priority to its project on accounting for income taxes. [see page 4]

- o The AICPA Board of Directors should urge the FASB to continue and, if possible, accelerate its research efforts related to the information needs of users of the financial statements of private and small public companies. [see page 6]

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Representatives of the accounting standards division will be available to discuss those comments with you at your February meeting.

Sincerely,

Roger Cason

Roger Cason
Chairman
Accounting Standards
Executive Committee

RC:rj
Enclosure

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